

1-1-1986

Selecting Joint Venture Partners is Easy ... Almost

J. Michael Geringer
Southern Methodist University

Follow this and additional works at: https://scholar.smu.edu/business_workingpapers



Part of the [Business Commons](#)

This document is brought to you for free and open access by the Cox School of Business at SMU Scholar. It has been accepted for inclusion in Historical Working Papers by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

SELECTING JOINT VENTURE PARTNERS IS EASY...ALMOST

Working Paper 86-081*

by

J. Michael Geringer

Assistant Professor of Business Policy
Edwin L. Cox School of Business
Southern Methodist University
Dallas, Texas 75275

- * This paper represents a draft of work in progress by the authors and is being sent to you for information and review. Responsibility for the contents rests solely with the authors and may not be reproduced or distributed without their written consent. Please address all correspondence to J. Michael Geringer.

Abstract

Based on interview and questionnaire data obtained from over 100 executives from U.S.-based corporations, this paper discusses the process by which partners have been selected for joint ventures (JVs). The paper begins by briefly highlighting the importance of the partner selection topic, arguing that potential long term compatibility deserves increased emphasis when selecting JV partners. Several selection criteria related to compatibility are identified and discussed, using numerous illustrations from actual ventures. The paper then outlines the partner selection process, including discussion of the key individuals who are involved, how contacts are initiated with prospective partners, what the role of top management is, and where and by whom final decisions are made. The paper concludes by noting that JVs are typically characterized by on-going negotiations, suggesting that it may be unwise for managers to approach the process with a zero-sum game mentality.

In light of the recent groundswell of interest in JVs and other forms of interfirm collaboration, it is expected that this paper will be of interest to managers and academics from both descriptive and normative standpoints.

SELECTING JOINT VENTURE PARTNERS IS EASY . . . ALMOST¹

A small technology company, let's call them Alpha Corporation, developed an advanced design for a computer peripheral. Lacking the manufacturing and marketing acumen, as well as the financial muscle, necessary to rapidly commercialize this breakthrough, Alpha's managers decided to seek assistance via a joint venture (JV). They approached several firms and, after spending much time in analyzing the technical compatibility between their own and their prospective partners' companies, agreed to venture with one of the dominant firms in the industry. They announced their decision amidst great fanfare--press releases, a company-wide celebration, champagne. Analysts lauded the decision and predicted spectacular results. Alpha's stock nearly doubled in value.

Another success story from the Silicon Valley, right? Wrong! Within a year the venture had been dissolved, Alpha's stock price had tumbled, and the executives who helped set up the venture had departed for greener pastures. What had happened? According to the survivors of this debacle, the JV confronted problems almost from Day One. Because of differences in the partners' sizes and management styles, venture teams constantly complained of an inability to work together. Managers from Alpha, used to making quick decisions and then acting upon them, were frustrated by the slow moving bureaucracy of their larger partner. Alpha's designs were repeatedly, and their employees thought unnecessarily, subjected to modifications by the partner's researchers. Product introduction was delayed by several months when the partner unexpectedly transferred several critical personnel to another project. Complaints to the partner's headquarters frequently appeared to be ignored. The venture was ultimately terminated at significant financial cost to both partners. To make matters worse, the delays enabled one of Alpha's competitors to beat them to the market with a similar product.

¹The author would like to gratefully acknowledge the Edna Benson Foundation, Touche-Ross, and the participating executives. Their assistance made this article possible.

Alpha's managers did not adequately consider the differences between selecting a partner with compatible skills and selecting a compatible partner. They wanted to establish a venture which would achieve corporate objectives, but this meant different things to the two companies. The Alpha Corporation example is especially insightful because a surprising number of managers do not probe deeply enough into the issue of compatibility between their own and their prospective partners' companies. They want very much to believe that they are building a lasting relationship with their partners--but they're not. Establishing a lasting JV relationship is a complex process, and the degree of compatibility between partners is but one variable influencing that process. Yet, although selecting a compatible partner may not always result in a long-lived and successful joint venture, selection of an incompatible partner virtually guarantees that the venture's performance will be unsatisfactory.

Previous studies have devoted most of their attention to motivations for forming a joint venture, as well as managing the venture once it has been established. In contrast, this article and the research project on which it is based (see insert) emphasize the process of selecting joint venture partners. The discussion which follows is based primarily on a series of interviews with corporate executives regarding the joint venture experiences of their companies. These executives, most of whom occupied positions at senior levels of their management hierarchies, had been intimately involved in the process of identifying and selecting partners for one or more JVs. This article describes how executives perceive the partner selection process, with some emphasis on how prospective partners are identified, what criteria may be employed when evaluating a company's suitability as a partner, and who is typically involved in the selection process.

IDENTIFICATION AND SCREENING OF PARTNERS

Finding and courting a partner for a joint venture can be an expensive process. Costs are not limited to negotiating and writing the legal and operating agreements. Substantial amounts of time and other resources frequently must be expended in identifying and screening prospective partners prior to the venture's formation. This is particularly imperative when the company's management has only limited prior experience with the proposed venture's products or markets, although the costs can be substantial even if managers already have a thorough knowledge of the venture's industry.

(Insert)

RESEARCH DESIGN

This article is based on a research project that explored U.S.-based companies' experiences in selecting partners for joint ventures. In his fieldwork, the author examined the process by which managers identified, evaluated, and selected prospective partners. To insure spontaneity and openness in responses, anonymity was guaranteed for all participants and their companies.

Data was collected on numerous topics, including what partner characteristics were most actively sought--and avoided; how initial contacts were made with prospective partners; which managers were involved in partner identification and evaluation, and what roles they assumed; and how and by whom decisions were made regarding whether, and with whom, to form a joint venture.

The author conducted extensive, generally multihour, interviews with over 100 managers who had been intimately involved in selecting partners for over 250 joint ventures from a wide range of industries. The majority of the ventures had target markets which included at least one of the industrialized nations. Nevertheless, based on comments by the participants, most of the findings should also apply to joint ventures which were not principally oriented toward serving developed country markets.

Despite its importance, managers may hesitate to devote a significant amount of corporate resources to the process of identifying and evaluating an extensive list of viable partner prospects. This is particularly the case when a partner with the minimum basic technical requirements appears to have been found--through an introduction at a convention or trade show, a comment from a colleague, or some other means. Often, partners appear to have been chosen for reasons not fully relevant to the organization's objectives and without a stringent comparison of alternatives. Many JV partners seem to have been selected almost by accident, or at least without full consideration of how they might influence the JV's operations. This tendency to abbreviate partner selection efforts may help account for the widespread perception that joint ventures tend to be fraught with problems, including inferior performance, and that they commonly "fail" within a relatively short period of time.

PARTNER IDENTIFICATION REQUIRES RESEARCH

As with many other aspects of JV formation, identification of viable partner prospects is a research task. Managers need to be aware of their firm's strengths and limitations before taking the first step in searching for prospective partners. At a *minimum*, partners should be able to provide the additional capabilities which, in both the short and the longer-term, are necessary to enable the venture to be competitive. This means that a manager must analyze the venture's anticipated target market, as well as the businesses which prospective partners are currently in or likely to enter in the relatively near future, in order to identify possible synergies. However, unless a manager has a thorough knowledge of the venture's industry and the potential players, reliance on superficial scanning efforts is unlikely to result in an optimal partner selection decision. Particularly for fast-moving technologies, such as telecommunications, biotechnology, or robotics, managers should be cautious about making assumptions regarding other firms' capabilities. Reputations may be misleading, and many an executive has felt blind-sided when he belatedly discovered that a partner did not have the skills necessary for the JV's success.

When identifying partners, there is no single approach which will be preferable in all situations. The evaluation must consider such factors as the peculiar characteristics of the industry, your firm's competitive position, and the venture's anticipated requirements for capital and other resources. Typically, among the first potential partners to be considered are the distributors, suppliers, and customers for the industry of the proposed venture. Yet, even these companies must be examined to see which ones are available for venturing and

which might be preempted from participation due to prior agreements with competitors or similar reasons.

Of course, extensive search and screening efforts are not always a feasible option. Sometimes, the nature of the proposed investment dictates that the range of prospective partners is limited. For instance, there may be only one firm with access to the technology or raw materials needed by the JV. In other cases, government fiat or regulations regarding foreign ownership may sharply limit the number of available partner prospects. However, even if only one or a few viable partner prospects are perceived to exist, this does not diminish the importance of screening these companies for suitability as JV colleagues. Conflicts between partners are best avoided if anticipated before the venture is established, so extreme care should be taken in selecting the other party, or parties. The additional effort you expend up-front in selecting the "right" partner may repay itself many times over in avoided costs of misunderstandings, delays, and divorce.

CRITERIA FOR SELECTING PARTNERS

Attempting to define a set of criteria for selecting the "right" partner would be roughly analogous to trying to tell a person how to pick the "right" spouse--certainly a difficult, if not an impossible, proposition. The selection of a partner who will be compatible in the long term is a complex and individualistic endeavor. Each joint venture is unique in its own way, and must be approached accordingly. Yet, there do seem to be common elements to many JVs. As a result, it might be possible to draw from the experience of other managers in suggesting guidelines to consider when selecting a JV partner. Several considerations regarding selection criteria are discussed below.

Seek Complementary Technical Skills and Resources

The primary selection criterion is generally a partner's ability to provide the technical skills and resources which complement those of your company. Generally, if prospective partners can not satisfy this criterion, then formation of a joint venture should be a questionable proposition, at best. Therefore, technical complementarity should be viewed as a minimum qualification for the selection of a partner.

Technical complementarity is determined by analyzing the critical success factors--those few areas strongly influencing competitive position and performance--which confront the proposed venture. Once this is done, you must evaluate your company's current and anticipated future competitive position

relative to these factors. Those areas where deficiencies are perceived to exist can serve as the basis for assessing the technical complementarity of a partner. However, your analysis should identify more than merely a financial deficiency--such resources may often be accessed via other options which will not entail the extensive managerial involvement of a partner. Although it may have appeal initially, a JV based solely on a partner's financial contributions is unlikely to foster long term compatibility.

Technical complementarity can assume many forms. A common alliance consists of technology supplied by one parent and marketing and financial capabilities furnished by the other. For example, an American medical equipment company wanted to expand sales of its product line in Europe. However, because of its small size and limited marketing experience and name recognition, the company was hesitant to undertake internal efforts at increasing penetration of the European market. Therefore, it sought the assistance of a joint venture partner. Strategic analysis of the proposed investment suggested that, at a minimum, a partner would have to be a recognized player in the medical supplies industry and have access to a sufficient level of financial resources and managerial talent. The partner would also need a given minimum level of sophistication with the relevant technologies so that its employees could competently demonstrate the technical advantages of the American firm's products. Companies which did not satisfy this set of criteria were rejected as possible co-venturers.

Seeking a partner with complementary technical skills and resources can permit each partner to concentrate its resources in those areas where it possesses the greatest relative competence, while diversifying into attractive but unfamiliar business arenas. Rather than intensifying weaknesses, JVs can thus be a means of creating strengths.

Mutual Dependency: A Necessary Evil

American managers have traditionally viewed dependency upon other companies or individuals as undesirable, and have avoided such situations whenever possible. However, in identifying suitable JV partner prospects, there should be some identifiable mutual need, with each partner supplying unique capabilities or resources which are viewed as critical to the venture's success. Proper matching should result in both partners perceiving that they have a vested interest in keeping the venture working, rather than resorting to some non-JV form of investment. By having one partner strong where the other is weak, and vice versa, mutual respect will be fostered and second-guessing and conflict can be mitigated.

Prior experience suggests that there should be a "middle level" of dependency between partners. If the level of dependency is too small, then the JV is unlikely to survive difficult times. On the other hand, too great of a dependency may prove unstable because of fears of the devastating consequences of the loss of a partner. The latter case commonly occurs when a small firm forms a JV with a much larger partner. The small firm may feel insecure, since it would be unable to fully exploit a market opportunity by itself, or only at a much slower rate and at a greater risk than might be the case in a shared endeavor. The smaller firm tends to be hungrier, and may need the sales revenues from the JV more than the larger partner. In addition, as discussed earlier with the Alpha Corporation example, association with a prominent partner may cause a smaller concern's stock value to rise. This is particularly worrisome if later termination of the venture is perceived as attributable to a failure to successfully commercialize the smaller firm's technology. While the larger firm may emerge from the venture virtually unscathed, JV termination may severely disable the small firm by causing customers, employees, and Wall Street to question the firm's viability. The resulting damage to its reputation may cause a precipitous decline in its stock value, harming morale and limiting the available strategic options.

Painful lessons regarding dependency between partners were experienced by many companies which, in the late 1970s and early 1980s, formed ventures with Asian firms as a means of rapidly accessing cheap labor or new markets. Frequently, the American corporations contributed the initial technology and some of the financing, and they trained their partners in the intricacies of running the business. Once this was accomplished, several of the ventures were dissolved and the partners later used technology obtained from the JV as a weapon against their former U.S. allies.

Several options are available for helping to insure that JV partners will continue to perceive themselves as mutually dependent. One method of reinforcing mutual dependence is to establish some means of "exchanging hostages." For instance, it is often possible to insert conditions into a JV agreement whereby a unilateral decision to prematurely break up the corporate marriage will result in a substantial charge of some sort, "alimony" payments if you will, as well as covenants against engaging in competing activities within a specified time period. It may also be possible to guarantee cross purchases of specified volumes of products or services by the partners. This option can help reduce the potentially devastating impact of a break-up upon a more-dependent firm by guaranteeing access to critical raw materials or sales revenues during the painful readjustment period. By employing techniques such as these, the threat posed by dependency on a partner can be reduced substantially.

Avoid "Anchors"

When contemplating a JV, be sure that your prospective partner is able to generate the given minimum level of financial resources necessary for maintaining the venture's efforts. Although this minimum amount varies dramatically between JVs, managers frequently note their avoidance of partners which are likely to become "anchors," slowing venture growth and development due to an inability or unwillingness to provide their share of the funding. As the vice president of a major manufacturing concern remarked, "Partners will almost always have differences of opinion regarding expansion. A small company may have fewer financial resources available for shouldering its portion of an expansion, or have to pay a higher financing rate than does the larger partner. This can not only cause operating problems, but may also result in some bruised egos, which can further intensify the difficulties."

A partner's inability to fulfill its financial commitments, whether due to small size, to financial difficulties in its other operations, or to the existence of different discount rates and time horizons, can create turmoil for the venture and its managers. Particularly in the early stages of a JV, when large negative cash flows are more likely to be encountered, the presence of an "anchor" can jeopardize an entire project, forcing a premature buy-out or termination. Commenting on his company's experiences with a smaller firm, one senior executive commented that, "The joint venture was functioning quite smoothly and was meeting or surpassing both companies' projections until the financial demands exceeded (the other company's) capabilities The resulting animosities ultimately caused the venture to be dissolved."

Although it is not always possible to identify potential "anchors," several tell-tale signs may suggest the need for further inquiry. As one executive suggested, "You have to look at the partner's balance sheet and ask: 'Is it a financially solid company?' You have to look at their plans for growth and their profit orientation. Is there a difference in the strategic importance placed on the JV's activities? Is the partner likely to confront financial problems in one or more divisions? If so, what will be the effect upon other activities of the partner, especially the JV?"

A prospective partner's resource constraints can constitute a significant hurdle to the establishment of a successful JV. However, if proper precautions are observed, the presence of a partner with meager financial resources need not prevent JV formation or force a venture's termination. Especially when insufficient financial contributions are not due to financial insolvency, it may be possible to reduce noncompliance with the agreement by including penalties if

either partner attempts to back out of the relationship or otherwise sidestep its financial obligations. It might also be possible to stipulate that the companies can not engage in similar activities for a specified period of time. Furthermore, the agreement might be structured to allow shareholdings or payouts to be contingent upon the level of each partner's contributions, thus minimizing perceived inequities which might result from disparities in financial contributions. The use of these and similar mechanisms can reduce the undesirable effects of an "anchor" upon JV activities.

Relative Company Size: The Elephant and the Ant Complex

Relative company size is often of paramount concern when evaluating a prospective partner. Although exceptions are numerous, joint ventures often will have the best chance of succeeding if both parents are comparable in sophistication and size, preferably large. When a small company decides to JV and chooses a partner of similar size, the two companies frequently magnify each other's weaknesses. This is less often the case between two large firms, which are likely to have similar values and control systems, similar tolerances for losses, and similar appetites for risk. Crises are less common in large firms, particularly in regard to short term cash flow. Thus, larger companies typically offer greater "staying power," being able to commit a more substantial volume of resources over a longer time horizon.

Yet, sometimes a venture between firms of different sizes seems warranted. Size differences may yield synergies for the partners. A smaller company with innovative technology may decide to venture with a large corporation with the financial and marketing clout necessary to commercialize that technology, as was the case with the Alpha Corporation example. Similarly, Nike, an innovative designer of athletic shoes, teamed up with Nissho Iwai, Japan's sixth-largest trading company. And in 1978, Advanced Micro Devices, with \$62 million in sales, formed a joint venture with Siemens A.G., West Germany's largest electrical company, to produce a line of microcomputer systems and related products.

When partners evidence significant size discrepancies--dubbed "the elephant and the ant complex" by one executive--managers must be aware of the problems which may result. One frequently voiced concern is the possible domination of one company over the other, as addressed earlier during the discussion of mutual need. A related problem which may arise from extreme size discrepancies is that the different operational environments and corporate cultures of the partners may appear incompatible. For instance, the typically bureaucratic environment of many large firms, with a relatively slow decision

making apparatus and a voracious appetite for information gathering and analysis, sharply contrasts with the more entrepreneurial and quick-response orientation characteristic of small firms. A small business, accustomed to reacting within short time frames, may feel paralyzed by the seemingly glacial pace at which the larger company operates. Yet, the small company's prodding and sense of urgency may make the larger partner nervous--a nervousness which may seem justifiable. The large company may interpret its smaller partner's spartan environment and informality as indicative of a fly-by-night, shoe-string operation that may not remain in business for long. Furthermore, the larger firm may perceive that most or all of the risk is being borne by itself--educating a sales force and customers about a new product's features; assuming responsibility for warehousing, distribution, and sometimes production; lending credibility to the product, along with enhancing the prestige and financial status of the smaller firm. As a result, the larger firm may exercise even greater caution in its activities, further exacerbating the problem.

As the above suggests, differences in management style, decision making orientation, and perspective on time may effectively result in corporate culture shock, frustrating management from each partner and hindering the development and maintenance of good rapport. Therefore, a JV between companies of widely disparate sizes often necessitates the creation of a special environment in order to foster successful venture development. For instance, it might be possible to reduce the effect of partner size differences upon JV performance by giving the venture virtually a free hand in product development or other activities, minimizing administrative red tape and permitting quicker response time. This emphasis on autonomy might be a particularly appropriate option when the venture's environment is characterized by rapid change, and slow response might be akin to a kiss of death for the JV. The willingness of a partner to cooperate in this effort might constitute a critical factor in the partner selection decision.

Even when managers express a strong desire for working with a partner with a similar "systems" orientation, that need not dictate ventures between same-size corporations. On the contrary, the relevant measure often is not absolute corporate size, but the relative size of the respective business units. Therefore, managers may seek partners evidencing similar size at the business or division, rather than corporate, level. Another possibility for minimizing the effect of size differences is for a small firm to try to identify a large firm which is both hungry and has the marketing, financial, or technical muscle necessary for a successful venture. This may require greater diligence in identifying and contacting partners, however, since these are all attributes which tend to be found in certain individuals or business units rather than in the organization as a

whole. Yet, their presence helps ensure that the larger partner will be sufficiently aggressive to maintain respect from customers and competitors, and there is a greater likelihood that both partners will have similar perceptions of time as a vital component in the venture's success.

Strategic Complementarity: A Prerequisite for Long Term Success

Although partner size is an important criterion for many companies, it is commonly asserted that relative size is not as important as complementarity among the partners' strategic goals and objectives. Achieving a strategic fit between companies' objectives for the joint venture is necessary for maintaining long-term commitment to the joint venture. From the outset of discussions, each partner must strive to clearly understand what the other participants desire from the union. As one seasoned veteran commented, "It is remarkable how many joint ventures are consummated where one or both partners do not clearly state their objectives. Under these circumstances, venture failure is almost inevitable."

Different objectives in forming a particular JV, including the timing and level of returns on their investments, frequently produces conflicts of interest between partners. For instance, one executive reflected upon a previous JV involving his company and an Asian firm. He noted that the venture evidenced a lack of strategic fit between the partners' objectives: his company sought rapid market access and a high rate of dividend repatriation so that its stock price would be maximized, enhancing an expansion strategy based on exchanges of stock. The partner, on the other hand, sought transfer of technology and long term market development, rather than rapid financial returns. As a result of these differences, the JV performed poorly and was abandoned within a couple of years. The partner was reported to have used the acquired technological expertise to expand its own market position in Asia.

As partners' objectives diverge, there is an increasing risk of dissatisfaction and associated problems. This risk may be heightened when the venture's environment is characterized by a high level of uncertainty, since changes in a JV's operations are more likely under these circumstances. Unexpected events can cause problems because of the difficulty of formulating a mutually acceptable response to change. A power game can result, and the venture can collapse if the partners cannot reach an agreement on an appropriate course of action.

However, divergence of corporate objectives can lead to a venture's downfall even if performance is satisfactory. For example, Dow-Badische was formed in 1958 as a 50/50 joint venture between Dow Chemical and BASF of Germany, and it achieved good profitability over much of its life. Nevertheless,

despite \$300 million in annual sales, the venture was ultimately dissolved. BASF wanted to expand the venture, but Dow was reluctant to contribute additional capital since the venture's activities did not seem to fit within the firm's strategic focus. The gap between corporate objectives widened to the point where BASF bought out Dow's shares in 1978 and transformed the venture into a wholly-owned U.S. subsidiary.

Although determining the objectives of a prospective partner is often difficult, it is an essential task nevertheless. Failure to do so may significantly increase the prospect of later problems. The analysis needs to address not only the company's current situation and objectives, but also its likely future position. The rationale for this is that JVs frequently encounter changes in their operating environments, and it is essential that companies anticipate how their partner is likely to be affected by, and respond to, these changes. JVs only tend to work as long as each partner perceives that it is receiving benefits, or is likely to benefit in the relatively near future. Because of differences in objectives, what is good for one company may be a disaster for the other party.

An executive illustrated this situation through analogy to the search for a spouse: one must find a mate who is likely to change in similar ways with changes in the environment, or the relationship is unlikely to survive. Therefore, a compatible partner would ideally be one with similar values and objectives, in both a short and a long term sense. Such a situation will enhance the ability of managers to interpret one another's estimates, such as sales forecasts, development schedules, and cost estimates. This is particularly critical as the strategic stakes--the size of investment, potential effect on corporate image, or relationship to the organization's core technologies--increase in scale.

Evaluate Compatibility Between Partners' Operating Policies

Another consideration when selecting a partner involves the similarity of partners' operating policies and procedures. Executives related several instances where differences between the partners' policies--such as personnel procedures, accounting and finance conventions, and strategic planning cycles--had caused significant problems for JVs. For instance, one venture was nearly dissolved because inconsistencies between the partners' accounting systems repeatedly produced disagreement regarding timing of purchases, allocation of costs, and so forth. Since the JV was only marginally profitable, the method of reconciling disagreements could determine whether or not the venture would appear on the parents' books as a profitable operation, an important consideration for the division-level management teams. Another executive reported that differences in vacation policies between his firm and his European

partner created serious difficulties for their JV because the latter company shut down virtually all operations for a month each summer, whereas the U.S.-based firm allowed employees to schedule their own vacation time. As a result, the venture repeatedly encountered operationally-related difficulties.

Partners should be clear regarding the types of policies they will be comfortable working with. For example, a U.S. firm is typically accustomed to operating with a lower debt-to-equity ratio than is the case for a Japanese partner. These policies should be addressed thoroughly before the venture is formed. Differences in operating approaches may often result from cultural biases, and managers may not be conscious of their existence. They may take for granted that there is a "right" way to do certain things. As one Japanese manager stated, "Many American executives attempt to force their Japanese partners to adopt American methods of operation, in disregard of the distribution structure and other financial and management methods which have prevailed in Japan for a long time. For this reason, many joint ventures in Japan ultimately fail." As these examples illustrate, companies may frequently need to consider the compatibility of partners' operating policies and procedures when considering formation of a venture.

Be Aware of Potential Communication Barriers

Communication is another potential problem area. By nature, JVs tend to be fragile agreements, and communication problems make it even more difficult for them to function as intended. Basically, such problems may occur as a result of differences between national or ethnic cultures, including language, as well as differing corporate cultures. Cultural differences can impede the development of rapport and understanding between partners. You should not overlook the importance of a partner with adequate English-language capability, or your firm's facility with the language of the partner. The simple ability to communicate with one's counterpart in the partner firm can often make a significant difference in a venture's prospects for success, and the absence of this ability has been the cause of more than a few disasters.

Because of cultural or language differences, subtle nuances may be more difficult to communicate, thereby necessitating greater expenditures of time in negotiations and possibly delaying not only JV formation, but also major post-formation decisions. The use of buzzwords common to many industries tends to compound language problems. When buzzwords are used, misunderstandings can arise regarding each company's role in a joint venture. Especially in technology-oriented fields, commonly used terms may not have the same connotations for each partner. For example, specifications for the Boeing 767

jetliner called for fuselage panels to have a "mirror finish." Boeing's Japanese partners interpreted that specification too literally and engaged in excessive polishing efforts. As a result, the labor costs for the initial panels were excessive, necessitating further discussions to resolve the misunderstanding. Because of the risk of misinterpretations, it may often be advisable to attempt to substitute simple, "Dick-and-Jane"-type terminology for technical jargon during negotiations and follow-up discussions.

The existence of different cultural perspectives implies value systems that are not necessarily compatible; you cannot assume that promoting interests from one perspective will necessarily promote interests from another. However, managers should avoid the alternative assumption that different value systems will necessarily be incompatible. Values associated with different perspectives may be similar, even if only slightly, or they may be irrelevant to each other; it is not common for them to be in complete opposition.

Prior experience suggests that language and culture tend not to be insurmountable barriers, particularly for partners from industrialized nations, although they can be an important handicap. Therefore, although cultural barriers are often considered when evaluating prospective partners, and especially when choosing between two otherwise equivalent partner prospects, they seldom function as the dominant selection criterion.

Compatible Management Teams Help Reduce Problems

It may be desirable to select a partner whose management team is compatible with one's own. Personal rapport between the principal decision makers is often an important factor in the selection decision, and the inability of management to "take to each other" has frequently been cited as the basis for rejecting a prospective partner or for terminating a venture. Close personal relationships, particularly among the senior managers, helps to nurture the level of understanding necessary for a successful JV relationship. Managerial compatibility can enhance the partners' ability to achieve consensus on critical policy decisions, as well as facilitating efforts to confront and overcome the frequent roadblocks encountered during joint venture formation and operation.

Although building relationships between partners' managers takes time—a commodity many executives perceive to be in short supply when pursuing formation of a venture—it is an invaluable element of most successful JVs. This particularly characterizes ventures with Japanese firms, for whom establishment of close personal rapport is customarily a requirement before business negotiations can be concluded.

In many ways, it may seem unfortunate that JVs are so heavily dependent on personal rapport between a few individuals. Because of the informal nature of these relationships, including extensive utilization of unwritten "gentlemen's agreements," reliance upon executive rapport may lead to unnecessary disputes and conflicts of interests at a later date. To reduce the prospects of such turmoil, an additional consideration when selecting a partner may be the likelihood of continuity among the critical personnel within a partner's management team. Continuity among the principal managerial participants can help minimize the incidence of misunderstandings between partners. In this regard, several managers commented that Japanese executives had expressed hesitancy about forming JVs with U.S. companies, because the typically higher levels of management turnover in American firms hindered establishment and maintenance of close relations among the partners' managers.

Trust and Commitment: Essential Elements of Long Term Relationships

Forming and operating a successful joint venture may not be synonymous with the maintenance of friendly and cordial relationships between the partners' management teams. The perceived trustworthiness and commitment of a partner appears to have been a pivotal consideration when selecting many JV partners. Human chemistry is essential to the development and maintenance of trust and commitment, and interactions between management help provide the necessary foundation for their establishment. These interactions permit each partner to gain a greater understanding of the people they will be working with, including their values, concerns, and needs, thus helping to assuage potential suspicions regarding a partner. One executive, noting the importance of mutual trust and commitment in the partner selection decision and the process for evaluating these traits, likened the process to a "mating dance." He visualized the prospective partners as cautiously approaching each other, trying to "strut their stuff" and create favorable impressions, engaging in an often lengthy ritual of evaluating the probability of mutual attraction and compatibility before either would commit itself fully to the venture. Without full commitment by both parties, JVs tend to become only short term relationships, or "flings," often followed by divorce and parent-less "children." For this reason, great emphasis tends to be placed on the selection of partners which evidence trustworthiness and commitment to the venture, particularly by executives with more extensive JV experience.

The need for trust and commitment between partners is especially critical if a proposed venture involves activities closely related to your firm's technological core. The technological core of many firms is the essence of their

corporate strategies and competitive advantage. A manager may understandably react with some level of initial distrust regarding potential partners' motives. It is useful to recall the inherent fragility of joint ventures when choosing partners, since today's partners could become tomorrow's competitors. As one CEO noted, "You've got to be sure that you're working with earnest and ethical people who aren't trying to undermine your company. Usually, a partner will have access to your trade secrets. He might attempt to complete a few projects, learn what you do, then exclude you from future deals."

Baring your technological core to a partner who is not able to adequately protect this knowledge from technological theft or bleed-through can threaten your company's competitiveness. As a result, an intuitive response may be to seek majority control, if not full ownership, of any venture, and then to hover over every decision the child might make—particularly if you do not trust a partner's intentions. Yet, such a response is unlikely to promote compatibility.

Many managers take the position that, given the likelihood of some misunderstanding between the partners, the JV agreement should address every conceivable contingency. In contrast, managers experienced in JVs emphasize the building of mutual trust and understanding, which make the formal written agreement more a symbol of a commitment to cooperate than an actual working document. As one C.E.O. commented, partners generally "don't start looking at the specifics of the venture agreement until the relationship starts breaking down and you're contemplating getting out."

Regardless of protections written into the JV agreement, no legal document is fail-safe. "You can write all sorts of legal contracts and other formal agreements, but the partners must trust each other and be committed to the venture in order for it to work," noted an executive. "A partner may be able to muster a virtual battalion of lawyers, making it very expensive for you to take a grievance to court, much less to win it." Therefore, you must be comfortable that the partner will honor the spirit, not just the letter, of the agreement. Often, particularly for ventures involving the Japanese, demands to develop extensive formal contracts dealing with every conceivable dispute will be viewed as evidence of mistrust. Managers are to be reminded that a JV relationship is delicate at best and complicated at worst, and without fundamental trust and commitment by each party there is little hope for a working partnership.

Although the preceeding discussion presents what may appear to be a rather long list of criteria, managers with JV experience will probably be able to add others. Admittedly, these suggestions constitute an ideal set of conditions, and there may be few situations where each of these will be fully achieved.

Nevertheless, the above provides a foundation for the identification and evaluation of potentially compatible JV partners.

JOINT VENTURE SPONSORS

In selecting JV partners, there are people from each company who play a particularly critical role in the process. Examination of prior ventures reveals that there are usually 1 to 3 key individuals, or *sponsors*, who are critical to the partner selection decision and to efforts to implement a joint venture agreement. Typically, these individuals become involved very early in the selection process and occupy line, rather than staff, positions in the upper-middle to upper levels of the management hierarchy.

The JV sponsors serve as catalysts for the process of identifying, evaluating, and negotiating with prospective partners. Because they function as the driving force for the venture's formation, their continued involvement in the partner selection and JV formation process is essential. For this reason, the existence of more than one sponsor in each partner company may enhance prospects for successful JV formation. When a company has only one primary sponsor, loss of that individual--due to transfer, turnover, or other cause--frequently either results in termination of formation efforts within a relatively short time period or significantly delays the negotiation process while relationships are established with the new sponsor. However, when more than one sponsor exists within a company, loss of one of them may create problems, but the process of forming and operating the JV is generally able to proceed with only minor delays.

Because of their central role in the formation process and the broad range of activities which must be addressed, certain types of managers seem to be more effective as JV sponsors. In general, successful sponsors have been characterized by skills related to broader and more generalized line capabilities, rather than evidencing more narrow technical specialties such as law, accounting, or other support functions. In addition to their general management orientation, at least one of the sponsors from each partner company should also be fluent with the principal function(s) which the JV is expected to engage in, such as R&D, manufacturing, or marketing. When sponsors embody these traits, their ability to evaluate and negotiate with prospective partners is significantly enhanced. Yet, despite this caveat, a surprising number of firms have delegated responsibility for partner selection and negotiation to staff members, especially lawyers, who may be ill-equipped to function as full-fledged sponsors of the JV. As a result, they are often unable to effectively champion the venture, further hindering formation efforts.

INVOLVEMENT OF TOP MANAGEMENT IS CRUCIAL

Especially for larger JVs and those accorded high strategic importance, top management of the company generally has some degree of direct participation in the partner selection process. These very senior level executives generally do not assume an active role as one of the key sponsors championing the venture. Nevertheless, their participation is often pivotal in the successful formation and functioning of a JV, due to their ability to communicate the company's commitment to a prospective partner as well as to employees within their own firm. Top management involvement can help prevent or overcome deadlocks or other disagreements between the partners' operating-level personnel. Their participation also confers legitimacy to the proposed JV, helping to develop and sustain the commitment necessary to successfully complete the process of partner selection and JV formation.

LOCATION OF THE PARTNER SELECTION DECISION

The final decision regarding partner selection is almost always made at the corporate level, usually involving a vote of the board of directors. However, except for very large JVs and those which are very intimately related to a company's core business activities, the *de facto* decisions regarding partner selection and venture formation are typically made by business unit or division level management, rather than at the corporate level. This fact further reinforces the importance of assigning extremely competent individuals to the JV task force, especially when those individuals are expected to function as the JV's sponsors.

THE ON-GOING NATURE OF JV NEGOTIATIONS

Managers should recognize that JVs are usually characterized by on-going negotiations, even after the initial stages of discussions are concluded and the joint venture is formally established. This is true regardless of the absolute sharing of the venture's equity. Whether the equity is split equally or if one partner has a majority share, consensus is still desirable on major decisions. A minority partner consistently finding itself outvoted and relegated to sub-par performance is less likely to perceive that its strategic objectives are being attained. As a result, the probability that problems will arise is increased.

It is inevitable that changes in the internal and external environment will occur. Under such circumstances, strict reliance on the initially negotiated contract may produce less than satisfactory performance for one or both of the

partners, thus threatening the venture's long term viability unless modifications are implemented. While not all aspects of a joint venture agreement may be subject to renegotiation, the principal impetus for re-opening discussions on some or all parts of the JV agreement is concern over potential inequities or domination. Since a balanced agreement is essential to the maintenance of trust, circumstances which produce perceived imbalances typically result in partner outcry and pressure for modifications to the agreement. To the extent that partners perceive incompatibilities between themselves and their venture mates and an inability to rectify the situation, what begins as a relatively minor annoyance may mushroom into a significant, and possibly fatal, source of friction.

One means of minimizing problems within a joint venture is to maintain continuity among the key personnel. Because of their on-going relationship with their peers in the partner organization, they are a critical element in the maintenance of mutual trust. Personnel changes, especially among the venture's sponsors, can threaten the personal chemistry which has been built up between partners and necessitate further negotiations to re-establish this human balance. Although several firms have consciously exploited this tendency as a means of re-opening negotiations, be forewarned that such a strategy may also entail significant risks.

AVOID ZERO-SUM GAME MENTALITY

In the end, the partner selection decision is generally based on non-quantifiable human judgment, especially the judgment of those individuals serving as the venture's sponsors. In this regard, managers should refrain from a tendency to approach negotiations as a zero-sum game. Because of the presumed long term nature of the relationship and the need for fostering mutual trust and commitment, attempting to "beat" the partner in the negotiation stage will generally prove dysfunctional in the long run. As one food industry executive stated, "The content of any proposed agreement should be reasonable for all parties. If you believe it's reasonable, don't hesitate to lobby strongly for it. However, it's useless to pursue an unreasonable agreement. Even if you're able to convince the partner to initially agree to it, he'll eventually feel cheated and the agreement will ultimately fail."

For some, the idea of cooperating with a partner appears to stand in direct opposition to a corporate value system holding self-sufficiency and aggressive competition as central ideals. Yet, regardless of the size or type of business, the JV must be founded and operated in the spirit of compromise and cooperation. A parent unwilling to recognize this principle should pursue other,

non-JV options, or it will find itself confronting constant difficulties. An inequitable agreement, unless remedied, can result in deadlocks or dissolution, causing the partners to suffer foregone opportunities, lost capital and other resources, and compromised proprietary information, as well as an enormous amount of stress and emotional anguish.

CONCLUDING REMARKS

Joint ventures marrying corporate partners can be a valuable option for many firms and projects, and may be a less harrowing option than going it alone. But caution is necessary when selecting a partner. It is easy for companies to get married, yet if the courting ritual is not conducted in a thorough manner, a divorce is likely. The result--long and acrimonious legal battles, parent-less "children," and possibly serious scars for one or more of the partners--may place the companies in a worse position than was the case prior to entering the JV.

Success or failure of a JV depends not only on a venture's underlying strategic rationale, but also on how well partner companies can work together, despite differences in management styles, strategies, resources, and culture. The effect of such corporate chemistry is difficult to predict and control, but it is a critical consideration since JV agreements usually provide each partner with an on-going role in the venture's management. Compatibility of the partners, beyond mere technical complementarity, is an important prerequisite for a successful corporate marriage. This is particularly important with regard to the selection of partners, due to the influence this decision may have on the JV's performance.

With regard to the identification of suitable partner prospects, analysis of past JVs suggests that there is no single approach which promises to provide optimal results in every situation. Rather, the method will be contingent upon the nature of the proposed investment. However, in developing criteria for selecting partners, it is essential that managers select a partner which offers strong prospects for developing an effective long term working relationship. Partners have a tendency to crystallize into personalities, of which some types may not be conducive to the venture's long term viability. Although satisfying the perceived technical requirements of the JV is a necessary element of the JV partner selection decision, it is generally not sufficient. It should be apparent that the partners, linked together, will form a complete business, both in terms of technical capabilities and in terms of their ability to successfully interact.

Management of a joint venture is different from typical business activities, because it may involve a mixture of, and sometimes clashes between, different

cultures, thought patterns, and attitudes toward competition. There is a strong tendency for managers, particularly those without significant prior experience in JV formation, to view their prospective ventures as unique. This often translates into a perception that the JV experience of others has only limited applicability for their own circumstances. However, adamant assertions of the "uniqueness" of a particular JV may often be overstated. Although each situation will evidence unique elements, there do seem to be common elements in some, if not all, aspects of the joint venture formation process. For this reason, the process of locating suitable JV partners should, when possible, be carried out with the assistance of competent advisors who are thoroughly familiar with the law and business practices of the target industry and market.

Because of the presumed long-term nature of most joint venture relationships and the costs associated with premature dissolution, there tend to be relatively high financial and human costs associated with the selection of partners for successful JVs. Firms must be willing to incur substantial search costs, including those associated with criteria development and partner identification and evaluation, as well as the extensive resource expenditures typically involved in the negotiation stage. In addition, the process needs to be approached with considerable patience and realistic expectations. If a company is unwilling to accept these preconditions, then it should probably consider other investment options, rather than trying to minimize resource expenditures by cutting corners on the quantity and quality of effort expended on the partner selection and evaluation process.

NOTE: The following is a partial list of papers that are currently available in the Edwin L. Cox School of Business Working Paper Series. A complete list is available upon request from:

Kenneth R. Ferris
Director of Research and Development
Edwin L. Cox School of Business
Southern Methodist University
Dallas, Texas 75275

- 85-400 "The Effect of the WPPSS Crisis on the Tax-Exempt Bond Market" by John W. Peavy, III, George H. Hempel and Jonathan A. Scott
- 85-401 "Classifying Control Variables," by Michael F. van Breda
- 85-402 "Measuring the Financial Impact of Strategic Interaction: The Case of Instant Photography," by Richard A. Bettis and David Weeks
- 85-403 "Efficient Data Handling and Inefficient Market Structures," by Marion G. Sobol and Albert Kagan
- 85-404 "Organizational Symbols: A Study of Their Meanings and Influences on Perceived Psychological Climate," by Suzyn Ornstein
- 85-405 "Downward Movement and Career Development," by Douglas T. Hall and Lynn Isabella
- 85-406 "Organization Structure and Financial Market Performance: A Preliminary Test," by Richard A. Bettis and Andrew Chen
- 85-700 "Financial Institutions and Markets and the Economic Development of Four Asian Countries," by Christopher B. Barry
- 85-800 "A Framework for Formulating Response to Environmental Complexity: A Tool to Manage Diversity," by William R. Bigler, Jr.
- 85-900 "Model Management Systems: Proposed Model Representations and Future Designs," by Gary Klein, Lynda Applegate, Benn R. Konsynski, and Jay F. Nunamaker
- 85-901 "Innovation Diffusion Models of New Product Acceptance: A Reexamination," by Vijay Mahajan and Yoram Wind
- 85-902 "Perspectives on the Management of Diversity: A Dynamic Viewpoint," by William Bigler
- 85-903 "Simulating Hedonic Labor Market Models: Computational Issues and Policy Applications," by Thomas J. Kniesner and John D. Leeth
- 85-904 "Simplified Assessment of Single and Multi-Attribute Utility Functions," by Gary Klein, Herbert Moskowitz, Sathiadev Mahesh, and A. Ravindran
- 85-905 "The Varieties of Consumption Experience: Comparing Two Typologies of Emotion in Consumer Behavior," by William J. Havlena and Morris B. Holbrook
- 85-906 "An Analysis of Divestiture Effects Resulting from Deregulation," by Andrew H. Chen and Larry J. Merville
- 85-907 "The Optimal Capital Structure Decision of Depository Financial Intermediaries: A Contingent Claim Analysis," by Andrew H. Chen, Neil A. Doherty, and Hun Y. Park

- 85-908 "Developing Model Strings for Model Managers," by Gary Klein
- 85-909 "Strategic Planning and the Relationship Between Growth, Profitability and Firm Value: An Empirical Study," by Nikhil Varaiya, Roger Kerin, and David Weeks
- 85-110 "Assessment of Multi-Attributed Measurable Value and Utility Functions Via Mathematical Programming," by Gary Klein, Herbert Moskowitz, Sathiadev Mahesh, and A. Ravindran
- 85-111 "Computer Aided Process Structuring Via Mixed Integer Programming," by Gary Klein, P. Beck, and Benn Konsynski
- 85-112 "The Board of Directors, Top Management Compensation, and Shareholder Returns," by J. Kerr, and R.A. Bettis
- 85-113 "An Evaluation of Estimation Procedures for New Product Diffusion Models," by V. Mahajan, C. Mason, V. Srinivasan
- 85-114 "The Impact of Variable Levies: A Discussion of the Costs and Benefits of the European Community's Common Agricultural Policy" by T. Smith
- 85-115 "The Effect of the Bankruptcy Reform Act of 1978 on Small Business loan Pricing," by J. Scott and T. Smith
- 85-116 "The Strategy-Structure Linkage: Conceptual, Methodological and Measurement Issues," by W. Bigler
- 85-117 "A Review of the Framework Oriented Literature on Culture and A Proposed Integration," by W. Bigler
- 85-118 "The Strategy-Culture Linkage: A Procedural Guide," by W. Bigler
- 85-119 "Toward A Theory of Business Level Strategy Research," by W. Bigler
- 85-120 "The Influence of Career Stages on Salespeople's Job Attitudes, Work Perceptions and Performance" by W. Cron and J.W. Slocum
- 85-121 "Stochastic Duration and Dynamic Measure of Risk in Financial Futures," by A. Chen, H. Park, K. Wei
- 86-011 "The Returns to Bidding Firms and the Gains from Corporate Takeovers: A Reexamination," by Nikhil P. Varaiya
- 86-012 "Culture, Key Events and Corporate Social Responsibility," by Lynn A. Isabella
- 86-013 "The Effect of Career Stage and Shared Values on the Interpretation of Key Events," by Lynn A. Isabella
- 86-014 "Systems Analysts Job Responsibilities in the "Profit" vs. the "Not for Profit" Sectors," by Albert Kagan, Marion G. Sobol, and Kevin Quarnstrom

- 86-015 "The Penn Square Bank Failure: Effect on Commercial Bank Security Returns," by John W. Peavy, III, and George H. Hempel
- 86-041 "Career Plateauing: Who's Likely to Plateau?" by John W. Slocum, Jr., William L. Cron, and Linda Yows
- 86-042 "Tax Reform and Housing: Likely Impacts of the Administration Proposal and the House Bill," by David C. Ling and Patric H. Hendershott
- 86-043 "Service Pricing in a Medical Library: A Constrained Goal Programming Approach," by John J. Rousseau
- 86-044 "Fee Assessment in a Medical Library: An Application of the Club Principle," by John J. Rousseau
- 86-051 "Extremal Principle Solutions of Games in Characteristic Function Form: Core, Chebychev and Shapley Value Generalizations," by J. Rousseau and A. Charnes, B. Golany, and M. Keane
- 86-052 "Expert Systems in University Admissions Decisions," by Michael van Breda
- 86-053 "Assessing Trade Show Functions and Performance: An Exploratory Study," by Roger A. Kerin and William L. Cron
- 86-071 "Application of the Means-End Theoretic for Understanding the Cognitive Bases of Performance Appraisal," by James P. Jolly, Thomas J. Reynolds, and John W. Slocum, Jr.
- 86-072 "Understanding the Pricing of Initial Public Offerings," by Andrew J. Chalk and John W. Peavy, III
- 86-073 "Managing Corporate Cultures Through Reward Systems," by Jeffrey Kerr and John W. Slocum, Jr.
- 86-074 "A Causal Analysis of the Impact of Job Performance on the Voluntary Turnover Process," by Ellen F. Jackofsky and John W. Slocum, Jr.
- 86-075 "Career Transitions of superiors and Subordinates," by Suzanne K. Stout, John W. Slocum, Jr., and William L. Cron
- 86-081 "Selecting Joint Venture Partners Is Easy...Almost," by J. Michael Geringer